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COMMENT

March 4, 1998

Ms. Jean A. Webb, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: Reproposed Rule 1.35(a-1)

Dear Ms. Webb:

The Committee on Futures Regulation of this Association (the "Committee") respectfully submits this comment letter to the Commodity Futures Trading Commission (the "Commission") in response to its request for comments on its notice published January 7, 1998 in the Federal Register 63 Fed. Reg. 695 (the "Release") regarding repropoed amendments to Commission Rule 1.35(a-1). The Association is an organization of 21,000 lawyers. Most of its members practice in the New York City area. However, the Association also has members in 48 states and 51 countries. The Committee consists of attorneys knowledgeable in the field of futures regulation and has a history of publishing reports analyzing critical regulatory issues which affect the futures industry and related activities.

Lawyers on the Committee represent clients with diverse perspectives on the proposed amendments. However, the Committee uniformly commends the Commission for its willingness to continually monitor the purpose of Commission rules and the impact of such rules in the futures industry. The Committee also appreciates the Commission's desire to receive input from market participants and those familiar with the industry practices before adopting or modifying Commission rules affecting the futures markets.

The Committee submitted a comment letter dated June 30, 1993 when the amendments to Rule 1.35 were originally proposed. The Committee commends the Commission for numerous major changes made in response to comments on the original rule proposal. These

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include the addition of commodity trading advisors as eligible account managers, the deletion of the "intermarket" requirement for qualification as eligible orders, the deletion of the "securities" requirement, and clarification that the rule is intended to impose a portfolio test rather than a test that focuses on individual transactions. However, absent confirmation, it is not clear that an account manager engaging in futures trading to implement an overlay or asset allocation strategy, but who does not manage the underlying assets, would be able to take advantage of the proposed rule amendments. The Committee believes that registered commodity trading advisors and registered investment advisers should be able to avail themselves of the proposed changes in these circumstances.

Eligible Orders - Reproposed Rule 1.35(5)(a-1)(i). The Commission specifically requested comment on the issue of whether eligible accounts require post-trade allocation relief in situations where futures orders are placed only on futures exchanges. The Committee believes that the proposal should be further modified to take into account the fact that average pricing systems, one alternative to the proposed expanded relief that is suggested in the reproposal, are not available on all futures exchanges. This method of relief, therefore, is not practicable in all instances. Furthermore, predetermined allocation formulas, which are proposed as another possible alternative to expanded relief, often apply only to orders placed for a single contract, and so cannot recognize or adjust for factors that might affect the implementation of a trading strategy on more than one market. Accordingly, the Committee recommends that futures-only orders placed on more than one futures exchange be eligible for post-trade allocation as well.

Eligible Customers - Reproposed Rule 1.35(a-1)(5)(iii)(5). Commodity pools are treated as eligible customers if they have total assets of at least \$5 million. The justification for this level is not specified and the Committee questions the need for any eligibility standard whatsoever because such a standard necessarily results in inequitable treatment of accounts which would otherwise be traded in parallel. A fixed asset level fails to address situations in which a pool may begin trading with more than \$5 million in total assets but may subsequently fall to a level smaller than this threshold amount, due to investor redemptions or trading losses. In such a case, does the pool remain eligible for the proposed relief? If not, it is possible that the pool could be traded in a different way at different times of its existence depending on its size. The Committee recommends that, if it is retained, the threshold level requirement be applied only at the inception of trading. The Committee is also concerned that implementation of this portion of the reproposed rule could lead to an increased likelihood of errors arising from inefficiencies in execution and administration on the clerical level.

The Committee also believes that the proposed rule does not address the business practice of combining several commodity pools

in a single "roll up" vehicle for accomplishing various trading efficiencies. In such an instance, does the threshold amount of \$5 million apply to the roll up vehicle or to the individual participating pools? The Committee believes that in such instances the threshold amount should be applied to the roll up vehicle rather than to its component parts.

The definition of "eligible customers" does not address natural persons as parties eligible for relief. The Committee believes that, without creating another category of qualified natural persons, the Commission should expand the eligible customer definition to include individuals with high net worth, such as qualified eligible client defined in Commission Rule 4.7(b)(1)(ii)(B). The Committee believes that as long as a registered commodity pool operator operates a pool, or a pool is subject to other comparable regulation, e.g. an offshore fund or a fund that has received exemptive relief, and such a pool intends to utilize the proposed relief, such pools should be permitted to utilize post-trade allocation procedures as provided in the reproposal. Such investors would, therefore, have the protections of the fiduciary standards and anti-fraud prohibitions that exist under the Commodity Exchange Act.

Proprietary Investment - Reproposed Rule 1.35(a-1)(5)(iii)(10)(B). In the Committee's 1993 comment letter, the Committee advocated a de minimis 10% level for proprietary investments in eligible commodity pools. Since that time, hedge funds and other hybrid trading vehicles have developed, along with business practices and client expectations of large capital investments by pool sponsors and/or advisors. A substantial proprietary investment in pools has become increasingly more common due to client demands and is likely to become the norm. The Committee believes that any numerical limit on proprietary investment levels is necessarily arbitrary. Accordingly, the Committee believes that a proprietary investment level in excess of 10% should be permitted so long as it is disclosed. In the absence of such relief, there is the risk that a fund could be disqualified from the relief included in the rule as investors redeem their interests and, consequently, proprietary investment increases above the 10% level.

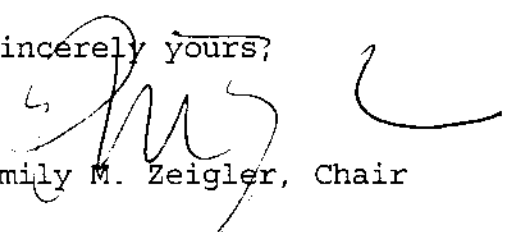
Recordkeeping - Reproposed Rule 1.35(a-1)(6)(vi)(E). This portion of the proposal would require making available comparable data for accounts traded by the eligible account manager. Although the proposal states that specific disclosure of customer identity is not required in these instances, there nonetheless remains the concern that the Committee raised in its 1993 letter, namely, disclosure of comparative account information might lead to identification of a particular client due to the size or composition of the portfolio, or to the disclosure of market strategies. Consequently, the Committee urges that the Commission delete this requirement. Instead, the Committee recommends requiring the availability of comparable trading data for audit by the National Futures Association as an alternative to mandated

client access to trading data. The opportunity to confirm comparable trading for all accounts would then be maintained without mandated exposure of proprietary information. To the extent that clients desire to obtain such information and advisors feel able to provide it, agreements between these parties can specify the manner in which it is provided and the safeguards deemed necessary to protect proprietary information.

Allocations - Reproposed Rule 1.35(a-1)(5)(v). The Release states that this rule requires that a futures commission merchant conduct reasonable inquiry as to the application of an allocation formula and refer to regulatory authorities any situations in which an account order allocation formula appears to be abandoned or there are significant departures from it. This requirement poses what the Committee believes to be an unreasonable burden upon the futures commission merchant, with an unwarranted and vague potential for substantial liability. An advisor is not the agent of a futures commission merchant. An advisor is appointed by the customer, who confers discretionary trading authority on the advisor through an advisory agreement. This business arrangement does not warrant or require placing an additional compliance obligation on futures commission merchants. This comment was also made by the Committee in 1993 and the Committee urges the Commission to reconsider it now. The Committee believes that ample regulatory authority imposing duties on futures commission merchants in this area exists under the Commodity Exchange Act and the regulations promulgated thereunder.

The Association appreciates the opportunity to comment on the Release and stands ready to assist the Commission if further clarification is required related to any of the points expressed in this letter.

Sincerely yours,



Emily M. Zeigler, Chair

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Committee on Futures Regulations

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\* Members of Subcommittee on CPO/CTA Regulation who drafted this lett  
of comments.

\*\* Chair of Subcommittee.

# Mr. Hickson did not participate in the comment letter.